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Redesigning Canadian Trade Policies for New Global Realities

Edited by Stephen Tapp, Ari Van Assche and Robert Wolfe

About this chapter

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Redesigning Canadian Trade Policies for New Global Realities, edited by Stephen Tapp, Ari Van Assche and Robert Wolfe, will be the sixth volume of The Art of the State. Thirty leading academics, government researchers, practitioners and stakeholders from Canada and abroad analyze how changes in global commerce, technology, and economic and geopolitical power are affecting Canada and its policy.

Small Business Traders in Canada

Ted Mallett

There are lofty expectations around trade policy discussions in Canada. Among supporters, free trade agreements, streamlining border-crossing rules and harmonizing national regulations are seen as the best ways to unlock trapped economic potential. Opponents of more open borders also expect large economic impacts from such policies, but falling on the negative side of the ledger. Although both sides generally come at this issue from a high-level, top-down trade perspective, the "real" economy is built from the bottom up, as thousands of individual businesses in Canada export and import products and services every day. For the most part, small and medium-sized enterprises (SMEs) are free traders, and the majority has strongly supported initiatives to expand and simplify market access and reduce trade costs, both within Canada and abroad. In this commentary, I attempt to convey some of the general views of the Canadian Federation of Independent Business (CFIB) and its members on Canadian trade issues and offer some policy recommendations.

First, it is important to recognize that, although international trade by large firms and multinationals operating in Canada attracts much of the public and policy attention, trade is also very much a small-business phenomenon (for the views of large business in Canada, see Manley and Kingston, in this volume). More than one in ten SMEs in Canada are direct exporters of goods or services (Industry Canada 2013). This might seem like a small fraction of the total, but SMEs made up 97 percent of Canadian goods exporters in 2014 (Statistics Canada 2015). As a group, SMEs account for over a quarter (26 percent) of the value of Canadian goods exports, and they likely make up an even larger share of the import side, where data by firm size are harder to come by. When *direct* trade is considered along with *indirect* trade — where SMEs act as intermediate suppliers to large firms that are themselves direct international traders as part of global supply chains — the contribution to trade from SMEs in Canada is further magnified.

Second, empirical research generally finds — and theoretical trade models often assume — that firms incur a fixed cost to trade (for a description of recent trade models, see Lapham, in this volume). This cost can include direct trade costs, such as those for shipping and fees for import duties, as well as indirect costs, such as the time required to learn about new markets, vet potential suppliers and fill out paperwork. Importantly, because fixed costs are the same for large and small firms, average trade costs fall as firm size increases. In effect, the nature of trade costs disproportionately restrain trade by SMEs — particularly smaller, lower-value shipments — relative to that of larger firms, which operate on a bigger scale and tend to have the higher profits needed to cover the costs of trade. Trade costs can, indeed, be quite daunting for many small businesses. In a 2015 CFIB survey of over 8,600 Canadian firms (Doris 2016), the vast majority (84 percent) of respondents whose SMEs traded with the United States said they use customs brokers, including services offered by UPS and FedEx, to help them trade.

Third, information gaps are crucial to better understanding the trade patterns of SMEs. In the 2015 CFIB survey, 59 percent of respondents whose SMEs imported from, or exported to, the United States said that border costs were higher than they had expected. Moreover, roughly one-third (34 percent) said that, if they had known about these costs, they would not have traded. These results suggest that the Canadian Border Services Agency (CBSA) should consider reviewing its fees and their impact on small businesses — and by extension on the Canadian economy — including reduced trade, fewer choices and higher prices. Even if such fees remain unchanged, these costs should be more transparent, particularly for potential first-time SME traders. Unfortunately, over one-third of respondents to the survey (37 percent) listed the user-friendliness of the CBSA website as "poor," a weakness that could be improved by developing a section dedicated to answering frequent trade questions and related issues of particularly interest to small business.

SMEs also have relatively limited awareness and take-up of existing government programs that encourage international trade, such as Advance Commercial Information, CANPASS, Free and Secure Trade, Partners in Protection, and NEXUS. Of these, only NEXUS, which expedites border clearance for low-risk, pre-approved travellers, is well known. This generalized lack of awareness of such programs might be because many are geared to the needs of large, frequent commercial traders — often involving considerable paperwork and lengthy approval processes. Indeed, such processes might discourage SMEs from using these programs even if they were aware of them. The answer, therefore, lies not only in promoting such programs better, but also in designing them to better meet the needs of Canada's small businesses.

Fourth, although policy attention often focuses on large trading firms and on exporting, for many businesses imports can matter as much as exports, since they are an intrinsic part of the production process. Companies do not export because they want to improve Canada's trade balance; they do so because it is profitable. Likewise, a key motivation for imports is that it often makes business sense to source from other countries. This allows Canadian companies to access cheaper or higher-quality inputs for their production, or inputs that simply are unavailable domestically. With the rise of global value chains, businesses, including small firms, are increasingly importing in order to export. Programs are in place to help firms import — an example is the duty deferral program that allows businesses to avoid being double-charged when they import products that eventually are exported — but once again, few SMEs know about them, and they could be designed to be easier to use.

Fifth, governments should avoid trying to pick winners. It is tempting to view the expansion of small business as a simple linear progression, starting with local markets, progressing to regional or provincial ones, then working nationally before making the leap across international borders. In reality, business start-ups often export from the beginning, while long-standing businesses remain resolutely local (see Sui and Tapp, and Ahmed and Melin, in this volume). Dynamic global supply chains are also giving rise to a new class of trading businesses that do not even move products across the Canadian border; instead, their goods are made in another country and sent directly to customers in different countries. Yet, policy-makers (perhaps because they prefer to design grand strategies with big announceables) like to link trade participation with business growth or technology development. Although this link is important in aggregate, growing firms are actually quite heterogeneous and hard to support with one-size-fits-all policies. Some people advise government to direct scarce resources to the small proportion of firms that are "high flyers." The problem with this approach, however, is that true "growth firms" tend to experience short, rapid bursts of expansion (Coad, Daunfeldt and Halvarsson 2015), which suggests that policies aimed at promoting the growth of individual firms might be able to identify them only *after* they have become successful, or ignore those that have grown slowly but are poised for a big breakthrough. In short, the success of a strategy based on picking winners is hard to demonstrate. Indeed, a selective and ambitious approach can do more harm than good to the economy because of the market-distorting effects of direct government intervention. In general, small business owners oppose the awarding of grants and subsidies to specific businesses, instead preferring broader framework policies, such as those aimed at removing barriers and improving the overall small business operating environment.

Policy Recommendations

Governments must consider the impact of their policies on overall business competitiveness. Longer-term policies to enhance competitiveness are preferable to shorter-term, high-profile measures. In particular, policy-makers should continue making incremental progress on initiatives that are already in place. The CFIB and its constituency strongly support, in principle, the work of the Regulatory Cooperation Council in its attempts to harmonize product regulatory requirements across the Canadian-US border. In practice, however, that progress has taken longer to reach the small business sector because initial efforts have focused mainly on the automotive and pharmaceutical sectors. Moreover, the progress that has been made can easily be swamped by new regulatory barriers.

Likewise, the CFIB supports the Beyond the Border initiative because of its attempts to streamline and simplify cross-border movement of goods and people. For SMEs, the process has not been easy: there are challenges in dealing with border security, and large-volume traffic gets attention first, while small business, small volume traders often take a back seat in these discussions. Moreover, many owners of SMEs cite the cost and complexity of do-it-yourself trade, as reflected in the increasingly common use of broker-facilitated trade. Indeed, many SMEs report continued difficulties even in sending people across the border for sales or service functions.

All of this reinforces the importance of Canadian governments keeping overall business competitiveness in mind when designing policies — especially on taxation and regulation — even those that do not have an obvious direct bearing on international trade: governments can slow down business through a thousand small cuts, not just by one or two big slices. Governments thus need to do more to enhance the trade experience for Canadian SMEs. A priority should be to ensure that trade information is more easily accessible and tailored to SMEs, particularly first-time traders. The CBSA should improve information access through a single-window initiative on its website with a dedicated section aimed at SME traders, while upgraded computer systems at border crossings could help expedite the completion of trade documentation. Governments should also raise awareness of existing trade programs and ensure they are designed to meet to the needs of SMEs.

A more general policy goal — one not restricted to international trade — should be to reduce the administrative burden on SMEs. The newly-elected government should continue to use the one-for-one rule on regulation, whereby any new regulation must be offset by eliminating or modifying another existing regulation. As well, the CBSA should report publicly on whether its service targets are being met. Such reporting would increase the accountability and transparency of the trading system and, ultimately, improve the services received by SMEs that conduct cross-border trade.

Because efforts to reduce trade costs disproportionately benefit SMEs, the CFIB recommends an economic impact assessment of all border fees. This could include a thorough review and consolidation of Canada's overly complicated tariff classifications, which would make life easier for small business traders. All firms — but particularly SMEs — would benefit from more clarity and consistency on customs procedures and costs *before* they trade. As well, to help reduce costs that fall more heavily on SMEs, duties should be waived on small-valued shipments — say, those below the $2,500 threshold under the Courier Low Value Shipment program, where reduced duties already might apply. In some cases, these fees exceed the value of the underlying product or service, rendering such trade uneconomical and causing undue administrative burden on the federal government in exchange for little revenue.

Finally, Canadian governments should recognize the importance of internal trade, and work to reduce trade barriers within the federation by updating the Agreement on Internal Trade, and avoid being seduced into pouring all of their policy attention into helping firms seek new and exotic international markets.

In sum, the federal government should continue making incremental progress on existing trade programs that show promise — such as the Regulatory Cooperation Council and Beyond the Border initiatives — change policies to promote internal trade, reduce red tape at the border, make it easier for small businesses to access relevant government information online, and design and promote programs with SMEs' needs in mind. The trading experiences of SMEs would be improved more with a modest policy approach than with grand strategies that involve trying to pick winners. And by encouraging more SMEs to trade, the Canadian economy and Canadian consumers would stand to benefit.

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